Internal Revenue Service

memorandum

CC:TL-N-9025-89
Br4:JRDomike

date: OCT 0 3 1989

to: District Counsel, Thousand Oaks W:THO

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Request for Tax Litigation Advice
[redacted]
Propriety of Income Tax Assessment for [redacted]

This responds to your request for tax litigation advice dated August 4, 1989.

ISSUE

Whether the assessment for [redacted] should be abated (assuming no jeopardy) where the taxpayer, in the accompanying amended return and letter filed simultaneously with the late-filed original return, asserted two grounds for zero tax liability, one based on net operating loss carryback, the other on exemption from income tax.

CONCLUSION

We agree with you that your office should recommend that the subject income tax assessment be abated (assuming no jeopardy exists).

FACTS

On [redacted] ("[redacted]" or "taxpayer") filed Forms 1120 (Corporation Income Tax Return) for [redacted], inclusive, in the office of the Director, Exempt Organizations Technical Division (Washington, DC) along with a check in the amount of $[redacted]. During these years, [redacted] had an application for exemption under section 501(c)(3) of the Internal Revenue Code pending with the Internal Revenue Service. By letter dated [redacted], the Service had denied exempt status and requested that [redacted] file corporate income tax returns. Information on the returns includes the following:

09175

Year	Form	Taxable Income	Tax
[redacted]	1120	$ [redacted]	$ [redacted]
	1120		
	1120X*		
	1120		
	1120X*		
	1120		
	1120		
	1120		
	1120		

* The 1120X was physically attached to the 1120.

The cover letter accompanying the returns states, first, that the amount of $[redacted] represents "the full amount of tax and interest due for those years, as shown on the returns." The letter then states:

> While the original Forms 1120 for [redacted] and [redacted] show a tax balance owing, this balance is reduced to zero as the result of the carryback of net operating losses from [redacted] and [redacted]. Forms 1120X are being filed simultaneously to reflect this reduction. Please ensure that these Forms 1120 are processed with the referenced amended returns so that only the amount of interest accruing on the underlying tax balance shown is assessed. ...

The letter requests that the Service apply the enclosed $[redacted] check to the accrued interest calculated to be due for the years ended [redacted] ($[redacted]) and [redacted] ($[redacted]). The letter concludes with the statement that [redacted] was and is a church within the meaning of Code section 170(b)(1)(a)(i) and an organization described in section 501(c)(3) exempt from the federal income tax on corporations, and that [redacted] is filing these returns under protest.

The two Forms 1120X (Amended Corporation Income Tax Returns) report tax deposited or paid with (or after) the filing of the original return, and refunds due in the amounts originally shown as tax on the Forms 1120.

On [redacted] the Fresno Service Center sent [redacted] a request for payment of corporation income tax for [redacted], including penalty and interest.

The transcript of account shows that for [redacted] through [redacted] [redacted] filed a [redacted] tax return. No module is present for [redacted]. It further shows no return indication for [redacted], and transfers the payment of $[redacted] to the [redacted] account. For [redacted], the transcript shows tax assessments per return $[redacted], assesses

delinquency penalties and interest, and credits two payments ($[redacted] and $[redacted]), with a module balance of $[redacted]. The two Forms 1120X are stamped "selected for audit".

Collection action has been temporarily halted by the Problem Resolution Officer, who has asked you for an opinion on the propriety of the assessment. You are considering three possible responses: (1) recommend abatement of the assessment on the rationale that the original return and the amended return must be read as a composite document; (2) recommend abatement on the rationale that the protest statement attached to the original return acts to negate any intent to self-assess the tax; or (3) recommend maintaining the assessment on the rationale that [redacted] filed a return that within the four corners of the official format confesses a tax.

DISCUSSION

General Principles

Section 6201(a)(1) of the Internal Revenue Code provides that the Commissioner "shall assess all taxes determined by the taxpayer ... as to which returns ... are made ...".

The Commissioner is authorized to abate the unpaid portion of the assessment of any tax or any liability which is erroneously assessed, I.R.C. § 6404(a)(3), and can make supplemental assessments. Id. § 6204. No claim for abatement of income tax can be filed by a taxpayer in respect of an assessment. Id. § 6404(b).1/

If an assessment has been made erroneously, it must be abated; then a correct assessment can only be made if timely within the limitations period of section 6501 and the restrictions of section 6213(a).

There is no statutory provision for amended returns. Generally, the treatment of amended returns is a matter of internal administration solely within the discretion of the Commissioner. Miskovsky v. United States, 414 F.2d 954 (3rd Cir. 1969). But that discretion can be upset upon a showing that it has been abused. Id. Where an amended tax return is not accepted as such, the government may treat it as a claim for

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1/ In this case, the taxpayer was able to have collection action temporarily halted by the intervention of the Problem Resolution Officer.

refund. Id., citing Rev. Rul. 57-501, 1957-2 C.B. 849, and Treas. Reg. § 301.6402-3. Where no tax was paid with the original return, the amended return does not qualify as a claim for refund of tax. See I.R.C. § 6511(b)(2).

If the return is filed late, or if the tax shown is not paid, late filing and late payment penalties will be due, unless the taxpayer shows reasonable cause for the delinquency. I.R.C. § 6651(a)(1) and (2); Treas. Reg. § 301.6651-1(c); Rev. Proc. 78-1, 1978-1 C.B. 550. Late filing or late payment penalties due with respect to tax shown on the return are not subject to deficiency procedures. I.R.C. § 6662. Interest is also not subject to deficiency procedures. I.R.C. § 6601(e)(1). Therefore, they are assessed by the Service Center when the return is filed. 2/

In exercising discretion with respect to an amended return filed simultaneously with the late-filed return, the Commissioner cannot ignore the amended return. When the amended return claims a net operating loss carryback, the tax liability of the return year computed at the end of the carryback year is reduced, possibly to zero; but from the return year to the carryback year the tax amount shown on the return was due and payable, and the Commissioner cannot totally ignore the tax amount on the original return for the return year.

Application to this Case

The Forms 1120 herein appear to be valid as returns. We see no basis to treat them otherwise. Therefore, the section 6501 period of limitation on assessment began when the returns were filed.3/

2/ Since a notice of deficiency does not suspend the statute of limitations with respect to the penalties and interest attributed to the tax reported on the return, the Service must make a timely assessment before expiration of the 3-year period of limitations. I.R.C. § 6601(g); § 6662(a)(1).

3/ Although I.R.C. § 6091(b)(2) governs place of filing, we recommend treating the earlier date when filed in Washington with the Exempt Organizations Technical Division as the date of filing, rather than the date when the package of returns reached the Fresno Service Center (as reflected in the postings to the account). As previously discussed, the Forms 1120 will be part of the I.R.C. § 7611 examination of this taxpayer.

The amended return Forms 1120X were filed to claim the NOL carrybacks. These forms are not valid claims for refund, as they claim refund of the tax which taxpayer did not pay. It appears that taxpayer intends to pursue its claim for tax exemption by filing claims for refund of the interest payments.

The Forms 1120 were late filed, and delinquency penalties and interest should be assessed, based on the amount of tax shown on the return. 4/

You suggest that Penn Mutual Indemnity Co. v. Commissioner, 32 T.C. 653 (1959), aff'd, 277 F.2d 16 (3rd Cir. 1960), would be authority for taking the position in this case that abatement may be required because the protest statement attached to the original return acts to negate any intent to self-assess the tax.

In Penn Mutual the taxpayer filed a return disclosing total tax due, enclosed no payment, but a letter attached denied tax owing on constitutional grounds. The Service did not assess, but issued a notice of deficiency in the amount shown as tax due on the return. However, IRS counsel moved to dismiss the petition in the Tax Court for lack of jurisdiction, on the ground that there was no deficiency and no determination of a deficiency. The motion was denied. Although the Service did not appeal the ruling, the Third Circuit sua sponte affirmed the denial, on the ground that a no-tax return is not self-assessing. The Third Circuit found that the attached letter was part of the return.

You further suggest that Paccon, Inc. v. Commissioner, 45 T.C. 392 (1966), would be authority for taking the position in this case that abatement may be required because the original return and the amended return eliminate the tax liability on the original return, resulting in no self-assessment.

In Paccon, the taxpayer filed an income tax return two years late showing tax due, without paying the tax. Eleven days later the taxpayer filed Form 843 (Claim) claiming an NOL carryback, and also that the taxpayer was a non-resident not subject to income tax. The Service assessed the tax shown on the return, and treated the claim as a claim for net operating loss carryback, resulting in an overassessment. In the notice of deficiency the Service determined the overassessment, and

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4/ This is routine service center procedure. The taxpayer may claim reasonable cause, which can be dealt with when appropriate. If the delinquency penalties are paid upon notice and demand, they will undoubtedly be the subject of a claim for refund on the basis of tax exemption. (See footnote 6.)

additions to tax for late filing and failure to pay tax. Part of the additions were attributable to the tax shown on the return, and part to additional tax due (deficiency wiped out by the NOL).

Although there may be two grounds for abatement, one abatement is sufficient. (A second "abatement" could not be made, in any event.)

We recommend abating the assessment based on the Form 1120X amended return claiming the NOL from later years. In connection with abating the assessment for 1982, the Service Center should post the return for [redacted], assess the tax per Form 1120, and interest and penalties, and abate the tax per Form 1120X. Then apply the check to each year's interest, as requested in the cover letter. As the taxpayer enclosed a check for the interest, and as the returns show -0- tax on account of the NOL carryback, this abatement carries out the taxpayer's request. (Penalty is discussed later.)

The taxpayer's request to assess only the interest payment is not correct and should not be followed. If the tax per return is not first assessed (and that assessment is required by section 6201(a)(1)) there would be no authority for assessing delinquency and failure-to-pay-tax penalties (or the interest taxpayer paid, for that matter). Excess assessed interest would be abated.

We further recommend treating the check as payment of interest, rather than a deposit in the nature of a cash bond. See Rev. Proc. 84-58, 1984-2 C.B. 201. The taxpayer did not request that the moneys be treated as "deposits" only, or state that they were intended as a "cash bond." The taxpayer stated that the check represents the full amount of tax [$0] and interest due for those years as shown on the returns. Treating them as payments of interest does not violate the revenue procedure in the circumstance here where the tax assessed per return is abated per the amended return.

The simultaneity of the returns in this case does not alter the fact that each return constitutes the return for the particular year. The taxpayer has filed the Form 1120 together with a Form 1120X claiming carryback, and the corresponding Form 1120 for the carryback year. The amended return based on the carryback is the result of the return filed for a year subsequent to the original year. The return for the earlier year should be posted first and dealt with as filed, before dealing with the amended return claiming NOL carryback. As noted before, the Service's treatment of the amended return is discretionary. With or without assessment, the Service will continue to audit the carryback returns.

Our recommendation -- assessment followed by abatement -- does not, in our view, conflict with Penn Mutual or Paccon.

Paccon and Penn Mutual uphold notices of deficiency issued by the Service. They are not assessment or abatement cases. While instructive, they are both distinguishable. Therefore, we do not find that either case mandates only one procedure to follow here.

In Paccon, the carryback NOL claim (or amended return) was not filed with the return, and the tax shown on the original return was assessed. The claim asserted zero tax on two bases: (1) NOL carryback, and (2) exemption from tax. After the Service considered the amended return, it issued a notice of deficiency determining a deficiency in late filing penalty, but an overassessment in tax. The Service allowed the NOL carryback, implicitly rejecting the claim for exemption, so the claim amended the return but only as to the NOL, not the asserted exemption.

In Penn Mutual, no amended return or claim for NOL carryback was filed. The Service did not assess the tax shown on the return because of the accompanying letter claiming the tax unconstitutional, but it did issue a notice of deficiency in the amount of the tax, implicitly denying the claim. The Tax Court and the Third Circuit held that the notice of deficiency gave the Tax Court jurisdiction (because there was an asserted deficiency in tax, which was not the case in Paccon).

What constitutes "the return" is a question of fact. In Paccon, the claim for NOL carryback was treated as an amended return and the claim for exemption was not. In Penn Mutual, the court held that the return plus the covering letter constituted a "zero-tax return."

As in Paccon, the claim for exemption here should not be treated as a zero-tax return, because of the intervention of the NOL carryback claim.

In Penn Mutual, there was no NOL carryback claim. Furthermore, there was no payment. In this case, there is a payment. If the Service were to treat the returns and letter in this case as in Penn Mutual, it would have to abate the assessment, and, contrary to the express instruction of the taxpayer, hold the check as a deposit without interest. See Rev. Proc. 84-58, supra.

The Service has already considered [redacted]'s application for tax exemption and rejected it. When the Service denied exemption, [redacted] had the option under I.R.C. § 7428 to petition the Tax Court

(among others) for declaratory judgment on this question, and chose instead the course of action to which we are responding.

These circumstances distinguish this case from Penn Mutual.

In light of the case law discussed above,5/ it would be reasonable for the Service to treat the Form 1120 as the return, and the attached Form 1120X as a claim or amended return as in Paccon. Then the procedure recommended herein flows smoothly to permit assessing the tax per Form 1120, assessing late filing/payment penalty, abating tax per Form 1120X, and assessing and posting the interest payments per the cover letter.

Any other course creates problems of interpretation, and the Service's actions with regard to this taxpayer will surely result in litigation. One of the problems with this case is that the Service Center did not treat both years' returns ([redacted] and [redacted]) the same. Collecting on one and not collecting on the other, as the Service Center has attempted to do (whether intentionally or

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5/ The extant case law is summarized in M. Saltzman, IRS Practice and Procedure ¶ 10.02[1] (1981; Cum. Supp. 1989:1):

> A taxpayer must admit liability for a tax before it may be summarily assessed. If the taxpayer shows a tax on his return but denies liability for the tax by, for example, attaching a letter refusing to pay the tax because it is unconstitutional, or by a protest that the tax laws are not applicable to him, the amount of tax shown on the return is considered to be zero. Although the taxpayer has shown an amount on the return, he has not admitted that amount is due and collectible. Therefore, any tax determined to be due may not be summarily assessed; rather the normal deficiency procedures apply. What happens when a taxpayer files a return showing a tax due and then files an amended return or claim for refund showing no tax due? The Service may summarily assess the tax shown on the original return (without sending a notice of deficiency) and treat the amended return as a claim for refund. [Footnotes omitted.]

Neither the cases nor Saltzman address the facts here considered. In Paccon, the Service's ignoring the claim to tax exemption was not challenged; and is not discussed in Saltzman. We believe our recommendation to abate due to claimed NOL carryback will effectively dispose of the possible need to abate due to claimed tax exemption.

not), does not augur well for the Service. In our view, the taxpayer's manner of proceeding is straightforward and logical and not in conflict with any rule. The taxpayer is following the request in the [redacted] final adverse ruling letter to file Forms 1120 yet is preserving its claim to exempt status for future litigation. There is no prejudice to the Service in following it.

On the other hand, if the Service Center does not abate the assessment, the taxpayer can resist collection on the ground that there has been no valid assessment, relying on the Penn Mutual case. Abatement takes this litigating opportunity away from the taxpayer.6/

Delinquency Penalty

We also recommend abating the assessed delinquency (section 6651) penalties at the same time as the tax abatements are made.

The reason for abating the delinquency penalty is that the taxpayer arguably has reasonable cause for not filing the Forms 1120 earlier than it did. See I.R.C. § 6651(a)(1) and (2).

The Code provides that returns with respect to income taxes shall be made by "every corporation subject to taxation". I.R.C. § 6012(a)(2). Hopkins7/ states that generally, until ruled exempt, an ostensibly "charitable" organization is presumed a taxable entity and may be required to file corporate tax returns (Form 1120).8/ However, the current regulations under section 6033 provide that an organization claiming an exempt status shall file a return required by section 6033 (Form 990). Treas. Reg. § 1.6033-2(c). In such case, the organization indicates on the return that it is being filed in the belief that the organization is exempt but that the Internal Revenue Service has not yet recognized such exemption. See Rev. Rul. 79-30, 1979-1 C.B. 454.

6/ For this reason we recommend that no collection action be taken with respect to late-filing/failure-to-pay penalties assessed on the Forms 1120. However, the usual notice of assessment and demand for payment should be sent out. (But see the discussion of abatement for "reasonable cause".)

7/ B. Hopkins, The Law of Tax-Exempt Organizations § 33.1 (1987).

8/ See Treas. Reg. § 1.6033-1(c) and Rev. Rul. 60-144, 1960-1 C.B. 6536.

During this period from its organization and while its application for exemption was under consideration, [redacted] did not file a Form 990. Holding itself out to be a church, it would not, as an exempt organization, be required to. I.R.C. § 6033(a)(2)(A)(i), Treas. Reg. § 1.6033-2(g).

The organization filed the returns timely after its application for exemption was denied.

Abating the delinquency penalty can, we believe, be accomplished consistent with Treas. Reg. § 301.6651-1(c) and Rev. Proc. 78-1, 1978-1 C.B. 550, which prescribe how the taxpayer may make the affirmative showing of "reasonable cause", including filing of an affidavit. The organization's cover letter in this case described the circumstances of the late-filed returns. The returns were filed with the Exempt Organizations Technical Division which forwarded them to the Service Center, thus implicitly ratifying the assertions in the letter regarding the course of the organization's application for exemption. Therefore, we think an affidavit is not necessary.

Should the view prevail that the taxpayer did not have reasonable cause for filing and paying late, the penalty can be reasserted if a deficiency is determined. Until November of 1991, it can be summarily assessed.

This response has been coordinated with the General Litigation Division.

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